

STATE OF MAINE  
PUBLIC UTILITIES COMMISSION

July 28, 2004

EXAMINERS REPORT

NORTHERN UTILITIES, INC.  
Request for Approval of  
Reorganization (NiSource/Columbia  
Merger and Related Transactions)

Docket No. 2000-322

NORTHERN UTILITIES, INC.  
Request for Approval of Reorganization –  
Merger with NIPSCO Industries

Docket No. 1998-216

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**NOTE: This Report is written in the form of an Order; however, it is the Staff's recommendation only and does not constitute formal Commission action. Parties may file exceptions to this Report by close of business on Wednesday, August 4, 2004. We anticipate that the Commission will consider this case at its deliberative session on Monday, August 16, 2004.**

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**I. SUMMARY**

In this Order we impose no penalty on Northern Utilities (the Company or NU) for its failure to adhere to either of the approved post-merger corporate structures it proposed in *Northern Utilities, Inc., Request for Approval of Reorganization – Merger with NIPSCO Industries*, Docket No. 1998-216. We became aware of this situation in a later merger, *Northern Utilities, Inc., Request for Approval of Reorganization – NiSource Merger and Related Transactions*, Docket No. 2000-322 and directed Advisory Staff to determine whether a monetary penalty or modification of our Order in Docket No. 1998-216 was warranted by the Company's actions. The ensuing investigation did not uncover any evidence that NU's ratepayers were harmed as a result of using an alternate post-merger corporate structure. Therefore, while we consider the Company's

actions to be a matter of some concern, given the lack of evidence of harm to ratepayers resulting directly from deviating from the planned post-merger corporate structure or its failure to approach the Commission with this change, as well as the passage of time, we decline to impose a financial penalty. We also modify our original order in Docket No. 1998-216 to allow for the post-merger corporate structure that NU's parent, NiSource, ultimately selected.

## II. OVERVIEW

### A. Background

The merger involving NU and NiSource (NI) occurred on February 12, 1999 when NiSource acquired Bay State Gas Company (BSG) which was NU's parent at the time. We approved a stipulation allowing this transaction to proceed. *Northern Utilities, Inc., Request for Approval of Reorganization – Merger with NIPSCO Industries*, Docket No. 1998-216(June 12, 1998).<sup>1</sup> The Company proposed two possible post-merger corporate structures, which envisioned NU as a direct subsidiary of either NI (in the so-called "Preferred Merger") or of NI's largest utility, Northern Indiana Public Service Company (the so-called "Alternate Merger"). Thus, the only post-merger structural change for NU was the name of its immediate parent, not the addition of another corporate layer above it. It therefore appeared that the transaction would not greatly complicate our oversight of NU going forward. The Office of the Public Advocate (OPA) agreed to these structural parameters and our order specifically approved this as proposed and agreed to by the parties. See Docket No. 1998-216, Order at 4.

NI subsequently decided to move forward with a third alternative corporate structure, one where NU remained a subsidiary of BSG, which now was a subsidiary to NI, without notifying the parties to the prior stipulation and without requesting further Commission approval. This departure came to light in the Company's subsequent request for approval of a second merger, this time between NU's parent NI and Columbia Energy Group. See *Northern Utilities, Inc., Request for Approval of Reorganization – NiSource Merger and Related Transactions*, Docket No. 2000-322. In that docket, we directed Staff to investigate this matter further and to either recommend a penalty for failure to comply with our order in Docket No. 1998-216 or to propose a modification of that order. See Docket No. 2000-322, Order at 17.

B. Procedural History

In response to our directive, the Advisory Staff issued a Data Request to the Company on September 21, 2001 and the Company filed its responses on October 24, 2001. Based on several factors, Staff reached the preliminary conclusion that NU's ratepayers were not harmed by the use of a different post-merger corporate structure and thus a penalty was not necessary. These included the fact that NU had not had a rate case in many years and thus inter-affiliate expenses borne by ratepayers did not increase as a result of the merger; and NU subsequently proposed to modify the agreements governing charges for services provided between and amongst itself and affiliates in such a way as to essentially make it direct subsidiary of NiSource, Inc. as originally envisioned in Docket No. 1998-216.

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<sup>1</sup> The acquirer was known as NIPSCO Industries at the time. This entity later renamed itself NiSource, Inc.

With respect to the revised affiliate agreements, Staff believed it should hold off making a recommendation on a financial penalty until these agreements were either approved or rejected by the Commission. In January 2002, NU filed the first of these modified agreements in *Northern Utilities Request for Approval of Affiliated Interest Transaction with NiSource Corporate Services, Inc.*, assigned Docket No. 2002-21, and we approved it on July 2, 2002. The Company followed up in October 2002 filing *Northern Utilities Request for Approval of Affiliated Interest Transaction with Bay State Gas Company*, assigned Docket No. 2002-614, and we approved this request on March 3, 2003.

C. Record

The record of this proceeding shall consist of all orders, transcripts and documents (including data requests and responses) filed with the Commission in both Docket No. 1998-216 and Docket No. 2000-322.

### III. **DECISION**

The Company has stated that NI decided to change the post-merger corporate structure when it closed the NI/BSG merger due to the existence of a potential capital gains tax liability in Massachusetts under either of the corporate structures we approved in Docket No. 1998-216. It estimated the potential tax liability was approximately \$3.2 million to \$3.6 million. NI never consulted taxation authorities in Massachusetts directly but instead reached the conclusion, following discussions with its tax advisors, that a capital gains tax would likely apply.

We believe that NI's approach to researching this question, given its commitment to the Commission and to the OPA (a party to the stipulation) regarding the post-merger corporate structure, was half-hearted to say the least. Considering that NI ultimately decided not to go forward with the agreed upon post-merger corporate structure based on an *assumption*, we do not understand why the NI did not simply request that Massachusetts issue a formal opinion on whether a taxable event has occurred. In a worst-case scenario the answer would have been affirmative and NiSource would have moved on to another alternative. That alternative course should undoubtedly have included further discussions with the OPA as well as a request for the Commission to modify its original order in Docket No. 1998-216.

In hindsight, it seems reasonable to assume that a formal opinion issued by the Massachusetts taxation authority stating that a significant tax liability would have been incurred would have provided the Commission sufficient justification to look favorably upon a requested change from NiSource. Also, as noted in our June 20, 2000 Order in Docket No. 2000-322, "Northern's management and operation is, and has long been, integrally connected with that of Bay State." Order at 11. In addition, we believe that combining such an opinion with a pledge to overhaul the agreements governing charges to NU from its corporate parents/affiliates, and perhaps a rate stay-out period until such agreements had been modified and operated for a period of time, would have made it easier for us to conclude at the time of the NIPSCO merger that this post-merger corporate structure was not adverse to the public interest. Instead, the Company essentially took all of these steps after the fact and without seeking required regulatory approval of its revised corporate structure decision.

Advisory Staff concludes that NU's intention not to adopt the approved corporate structures after learning informally of a tax liability for doing so and accompanying decisions could support a finding that the Company's failure to comply with our Order was knowing and willful. This is because, even after this potential violation was identified in Docket No. 2000-322, the Company clearly stated that it had no intention of asking for a formal opinion from Massachusetts on the potential tax liability, or reconsidering NU's position within the corporate hierarchy. Nor did it request or plan to request that the Commission amend its Order in Docket No. 1998-216 to allow for its modified post-merger corporate structure. See Docket No. 2000-322, Bryant October 24, 2001 Responses to Data Requests, 01-01, 01-06 and Maassel May 18, 2000 Responses to 01-01, 01-02. Also see Docket No. 1998-216, Tr. A-129.

We find ourselves in a position where the Company appears to have been negligent at best and deceitful at worst. However as far as we can determine, NU's ratepayers have not been harmed by the Company's actions in this matter. Therefore, a decision to assess a penalty is simply a matter of whether or not the Commission wishes to send NU a message regarding its attention to detail in the reading of our orders.

Advisory Staff explored the range of penalties that we could impose. Staff relied on 35-A M.R.S.A §§1504 and 1508, which were in effect during the time of the offense. Pursuant to section 1504, each day that a party *willfully* fails to comply with a Commission order constitutes a separate offense. Section 1508 states that a utility that fails or refuses to obey a Commission order has committed a civil violation for which up to \$1,000 can be assessed for each offense. The Company was in violation of our

Order in Docket No. 1998-216 for 504 days -- from the closing date of the original NI/BSG merger, February 12, 1999 (per NiSource 1999 Annual Report to Shareholders at 42), to June 30, 2000, the date of our Order in Docket No. 2000-322 in which we approved the revised corporate structure. We conclude that we could assess a maximum penalty of \$504,000 if we applied the maximum penalty of \$1,000 per day for 504 days.

Because we found no evidence that there was harm to ratepayers or any apparent intent on NU's or NI's part to take advantage of the existence an extra layer of corporate management to the detriment of ratepayers, however, we decline to impose a penalty on NU. We note that, following our discovery of Northern's non-compliance, Northern acted conscientiously to file the necessary service agreements and resolve other details of the merger. Having worked with Northern's current management for many months now since this matter arose, we are comfortable that the Company's current local management does appreciate that regulatory compliance in every jurisdiction is essential, regardless whether the local entity, e.g. Northern - Maine, constitutes a small share of the larger entity. Recognizing that the larger entity, rather than simply local management, was involved in this non-compliance, we will remain alert for similar omissions resulting from the parent corporation. We will not hesitate to impose an appropriate fine should NiSource or Northern repeat this sort of act in the future.

#### **IV. CONCLUSION**

Accordingly, we decline to impose a financial penalty on Northern Utilities, Inc. in connection with the Company's failure to comply with our June 12, 1998 Order approving the Stipulation in *Northern Utilities, Inc., Request for Approval of Reorganization – Merger with NIPSCO Industries*, Docket No. 1998-216, for the reasons specified in the body of this Order.

Respectfully submitted,

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Carol A. MacLennan  
Hearing Examiner

And

Richard S. Kivela,  
Utility Analyst